Debt Conversion Transaction Update

June 1997

The PROFIT Project
Promoting Financial Investments and Transfers
1925 North Lynn Street, Suite 601
Arlington, VA 22209
(703) 276-0220
Fax (703) 276-8213

USAID Contract No. DPE-3056-C-00-1040-00

USAID

The PROFIT (Promoting Financial Investments and Transfers) Project seeks to mobilize the resources of the commercial sector to expand and improve the delivery of family planning services in selected developing countries. The PROFIT Project is a consortium of five firms, led by the international management consulting firm of Deloitte Touche Tohmatsu and including the Boston University Center for International Health, Multinational Strategies, Inc., Development Associates, Inc., and Family Health International.

This report is part of a series of PROFIT Research Studies, which address various topics related to private sector family planning. The studies grow out of PROFIT subprojects within the following three strategic areas: innovative investments, private health care providers, and employer-provided services.

PROFIT is supported by the Office of Population in the Center for Population, Health and Nutrition (G/PHN/POP) of the U.S. Agency for International Development (USAID), cooperative agreement number DPE-3056-C-00-1040-00.

A complete list and individual copies of PROFIT publications are available from:

The PROFIT Project
1925 North Lynn Street, Suite 601
Arlington, VA 22209
Tel. (703) 276-0220
Fax (703) 276-8213
E-mail profitproj@aol.com

PROFIT Requests Your Feedback

How have you or others in your organization used this report? How valuable were the contents? Do you know anyone who should be on PROFIT's mailing list?

Please phone, fax, or e-mail your comments on this report, your requests for other PROFIT publications, and your suggested additions to our mailing list.

We will use your comments and suggestions to improve our reporting and dissemination of the lessons and experiences of the PROFIT Project's work to involve the commercial sector in developing country family planning services.

ABSTRACT

This report of the Promoting Financial Investments and Transfers (PROFIT) Project reassesses the opportunities now available for debt conversion. When the PROFIT Project was developed in 1989, debt conversion was seen as a new way to leverage resources in highly indebted countries, and its use was incorporated into PROFIT's mandate to help leverage the resources provided to its subprojects. The use of such debt conversion techniques as debt-for-equity, debt-for-nature, or debt-for-development swaps peaked in 1990 and has fallen sharply since 1992, due largely to changing market conditions. In particular, the international response to the debt crisis—including the Brady Plan and the continual Paris Club restructurings—has reduced the indebtedness of many developing countries. This has raised the price (lowered the discounts) on debt available in the secondary market and therefore limited the potential gains from conversion transactions. Furthermore, the fact that many developing countries have reduced their debt to sustainable levels means they have fewer incentives to seek debt conversion.

ACKNOWLEDGMENTS

PROFIT would like to acknowledge the work of Adrienne Brombaugh, Senior Consultant with Deloitte Touche Tohmatsu, ILA Group Ltd., who helped prepare the first draft of this report, and Linda Griffin Kean, Consultant to PROFIT, who revised, edited, and updated the final draft. Lizann Prosser, Robert Bonardi, and Ann Sherpick of PROFIT also contributed to the report.

CONTENTS

FIGURES

ACRONYMS

CI	Conservation International
DDC	Debt for Development Coalition (now Finance for Development)
DM	Deutsche marks
FF	French francs
FFD	Finance for Development (now owned by New York Bay Company)
G-7	Group of Seven industrialized countries (Canada, France, Germany, Italy, Japan, United Kingdom, United States)
HIPC	heavily indebted poor countries
IDA	International Development Association of the World Bank
IDB	Inter-American Development Bank
IFI	international financial institution
IMF	International Monetary Fund
LIBOR	London interbank offered rate
London Club	informal group of major creditor banks formed to restructure commercial debt
MYRA	Multi-Year Restructuring Agreement
NGO	nongovernmental organization
ODA	official development assistance
OECD	Organization for Economic Cooperation and Development (Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, and United States)
Paris Club	Informal group of those creditor countries that guarantee private export credits against transfer or political risk, which collectively negotiate debt relief and reschedule debt; the bigger OECD countries are regular members, and other creditor countries such as Brazil participate less frequently
PROCOSI	Programa de Coordination em Supervivencia Infantil
PROFIT	Promoting Financial Investments and Transfers Project

UNICEF	United Nations Children’s Fund
USAID	U.S. Agency for International Development

EXECUTIVE SUMMARY

This report of the Promoting Financial Investments and Transfers (PROFIT) Project reassesses the opportunities for converting the debt of low- and middle-income developing countries. When the PROFIT Project was developed in 1989, debt conversion was seen as a new way to leverage resources in highly indebted countries, and its use was incorporated into PROFIT's mandate to help leverage the resources provided to its subprojects.

The use of such debt conversion techniques as debt-for-equity, debt-for-nature, or debt-for-development swaps increased rapidly after the first debt-for-equity program was initiated by Chile in 1985. Debt-for-development activities peaked in 1990 at $27 billion and have declined since 1992, mainly due to changes in market conditions. In particular, the price of the debt on the secondary markets has risen (i.e., the discount has decreased), reducing the potential gains that can be captured through conversion transactions. Also, a large proportion of debt conversion activity was linked to privatization programs in the developing countries, and these activities are being wrapped up. In fact, several countries have swapped their collateralized Brady Bonds for uncollateralized debt in recent years. Finally, the debt relief operations undertaken as part of the Brady Plan in the late 1980s and early 1990s have helped many indebted countries to improve their relations with commercial bank creditors, giving these countries more flexibility in managing their debt and reducing the incentives to seek debt conversion.

Under a debt conversion, an investor buys a country's outstanding debt on the secondary market at a discount off its face value. The investor then sells the debt instrument to the central bank of the debtor country for local currency at a negotiated price. The local currency is then invested in the debtor country, for example, to purchase assets or to fund development-related programs. The benefits of debt conversion are associated with two elements of the transaction: the *discount* on the debt available in the secondary market (compared to the face value) and the *premium* offered on the swap by the debtor country (compared to a simple foreign exchange transaction).

Debt conversions have been used by nongovernmental organizations (NGOs) to leverage the funds available for development projects in the debtor countries. However, conversion operations involve significant investments of time and resources on the part of the banks, NGOs, and other entities involved. There are now fewer opportunities for debt conversion due to rapid changes in emerging capital markets, and the profitability of such deals has been squeezed by high inflation and smaller discounts on debt in secondary markets. These factors, along with the high transaction costs, the lengthy negotiation periods involved, and the significant amounts of paperwork required, have made debt conversions much less attractive to most NGOs in recent years.

Nonetheless, some NGOs remain active in debt-for-development swaps. Three organizations in particular have been dominant: Finance for Development (FFD), New York Bay Company (which now owns FFD), and the United Nations Children's Fund (UNICEF). FFD and New York Bay conducted swap transactions involving $391 million in debt, including $29.7 million in 1996. The funds generated through these operations have been invested in health, population, agriculture, ecotourism, and low-income housing projects.

UNICEF has continued the debt-for-child-development programs that it pioneered. By 1996, UNICEF had completed 22 transactions that led to debt reduction of $199 million and generated local currency funds worth $53 million. These funds were invested in programs to support primary education, women in development, improvements in primary health and sanitation, and aid for children in special need.

Debt conversion specialists generally recommend that, to be worthwhile, a transaction should carry a potential premium of at least 25–30 percent. In countries where the transaction costs are particularly high and the procedures for debt conversion are not well established, the potential premiums must be even higher to make the transactions worthwhile. As noted above, changes in the secondary market for debt have made it increasingly difficult to find opportunities that promise returns sufficient to cover the transaction costs. For this reason, debt-for-development swaps are now undertaken by the few organizations that have significant expertise in this area.

1. INTRODUCTION

This report updates a study commissioned by the Promoting Financial Investments and Transfers (PROFIT) Project in October 1994, entitled *Blocked Funds/Debt Conversion Study: An Analysis of the Marketplace*. This report reassesses the opportunities now available for debt conversion. When the PROFIT Project was developed in 1989, debt conversion was seen as a new way to leverage resources in highly indebted countries, and its use was incorporated into PROFIT's mandate to leverage the resources provided to its subprojects.

Following the start of the debt crisis in 1982, the Paris Club—an informal group of countries that guarantee private export credits—introduced a series of revised terms for restructuring the official debt of highly indebted low- and middle-income countries. Over the next decade, there were a series of measures to offer debt relief by restructuring and rescheduling official debt (owed to creditor governments) and commercial bank debt. For example, under the Baker initiative, launched by U.S. Treasury Secretary James Baker in October 1985, highly indebted middle-income countries were to be provided a new infusion of commercial bank lending and lending from multilateral development banks to support structural adjustment programs. (See Appendix 1 for a list of indebted countries as classified by the World Bank.)

In addition to seeking debt *relief* through restructuring and rescheduling, many countries also sought debt *reduction*. In 1989, U.S. Treasury Secretary Nicholas Brady announced U.S. support for the voluntary reduction of debt and debt servicing for middle-income countries. Under the so-called Brady Plan, indebted developing countries were allowed to essentially buy back loans at a discount or to exchange them for securities that reduced their debt or debt service.

1.1 Debt Reduction by Conversion

Debt conversion is one of several tools for reducing the debt of developing countries. The benefits of debt conversion are associated with two elements: the *discount* on the debt and the *premium* on the exchange transaction. The discount refers to the gap between the market value of debt and its actual face value. The greater the gap, the greater the discount on the debt. The premium refers to the additional amount of local currency that can be obtained through a debt conversion over the amount that could be obtained through a simple foreign exchange transaction.

When Brady operations (available to middle-income countries) involve debt conversion, the debtor country issues long-term bonds, known as Brady Bonds, which are collateralized with debtor-purchased U.S. Treasury instruments. The bonds are paid to the commercial banks against the outstanding loans. The banks create a secondary market for the Brady Bonds and for other outstanding debt, selling the instruments at a discount. The price of the instruments fluctuates according to the risk that the debtor country would default on the scheduled interest payments. During the past few years, a number of countries have retired their Brady Bonds through market-based swaps or buybacks or have reduced their debt through restructuring. Their revived creditworthiness has reduced the debt available on secondary markets and has raised the price of the debt that remains available.

Some Paris Club agreements with lower-middle income countries and low-income countries also have incorporated conversion provisions. Debt conversion for low-income countries is voluntary between the creditor and the debtor country. During 1996, under the Heavily Indebted Poort Countries (HIPC) Debt Initiative, the Paris Club agreed to go beyond the Naples terms to provide debt reduction of up to 80 percent on a case-by-case basis.

1.2 Types of Debt Conversion

There are several debt conversion techniques. In a debt-for-equity swap, an investor purchases debt on the secondary market and then sells the debt to the debtor country's central bank for local currency that is used to purchase assets or make equity investments in the debtor country. Many countries used debt-for-equity swaps to support and augment their privatization programs, including Argentina, Mexico, and the Philippines. Debt-for-equity swaps peaked in 1990 at $27 billion, but fell sharply thereafter largely because of the conclusion of the large-scale Brady operations. Debt-for-equity swaps had virtually ceased by 1995, when only two significant operations were completed (both in Peru).

Debt-for-development swaps involve an international organization—usually an NGO—that purchases sovereign debt on the secondary market at a deep discount and then redeems the debt for local currency at a price negotiated with the country's government. The NGO uses the redemption funds to implement a development program in the debtor country.

The World Bank expanded the menu of debt reduction operations available through the Debt Reduction Facility to include debt-for-development swaps. This allows commercial banks to donate or sell debt to NGOs, which can then convert the debt into local funds for use in development projects. Only two countries have used such operations, Bolivia and Zambia, and no such transactions have occurred since 1994.

Another type of debt-for-development swap is a debt-for-nature operation, under which the redemption funds are allocated to nature preservation. The first debt-for-nature swap was conducted in Bolivia in 1987. Since then, 16 countries have retired $159 million in debt through the use of such transactions, at an average discount of 62 percent. Mexico alone has retired $1.9 million worth of debt through such swaps since 1994.

1.3 How Debt Conversion Works

A debt conversion is initiated by an organization (e.g., an NGO) that wants the local currency of an indebted country. At least three parties can benefit from a debt conversion transaction:

- The NGO can leverage its funds by buying, at a discount, the external debt of a country in which they intend to implement a project and subsequently redeeming that debt for local currency at a premium over that available through a simple foreign exchange transaction.
- A debtor country can benefit from a successful debt transaction by reducing its overall debt obligation which in turn can strengthen its economic profile and encourage external investments.
- The commercial banks holding loans that are at risk of default benefit by receiving immediate, albeit partial, repayment on outstanding loans and removing these high-risk investments from their portfolios. In addition, the banks' willingness to discount the debt may reflect their desire to trade their debt for hard currency.

Figure 1-1 outlines the six steps common to virtually all debt conversion transactions.

Figure 1-1. The Six Steps in a Typical Debt Conversion Transaction

Step 1: Preliminary Preparation	Determine if these preconditions exist: • External debt is available and eligible for conversion. • The process under which the conversion is to take place is explicitly stated by the debtor country (versus an ad hoc arrangement). • The discount is sufficient to make the transaction worthwhile to the NGO. • The debtor government is willing to approve the conversion. • The NGO project complies with the debtor country's criteria for use of debt conversion funds. • The benefits associated with such a transaction outweigh the costs. • The concerns of local partners and counterparts are understood by the NGO. • Sufficient funding is allocated to the transaction to guarantee its completion, even in the face of delays, inflation, etc.
Step 2: Design the Investment Project	Define the investment project and the plan for acquiring the host country's debt.
Step 3: Design the Financial Structure	Define what the host country will provide in exchange for the debt (e.g., cash, bonds, land), exchange rate to be used, percent of face value to be redeemed by the government, and costs of the transaction (e.g., taxes, commissions).
Step 4: Gain Authorization from the Host Country	Obtain approval for the conversion from the host country, usually through a formal application.
Step 5: Execute the Debt Conversion	Purchase the host country debt from the identified source and present the debt to the host country government in exchange for the agreed proceeds.
Step 6: Utilize the Proceeds	Implement the development project and comply with any host-country reporting requirements.

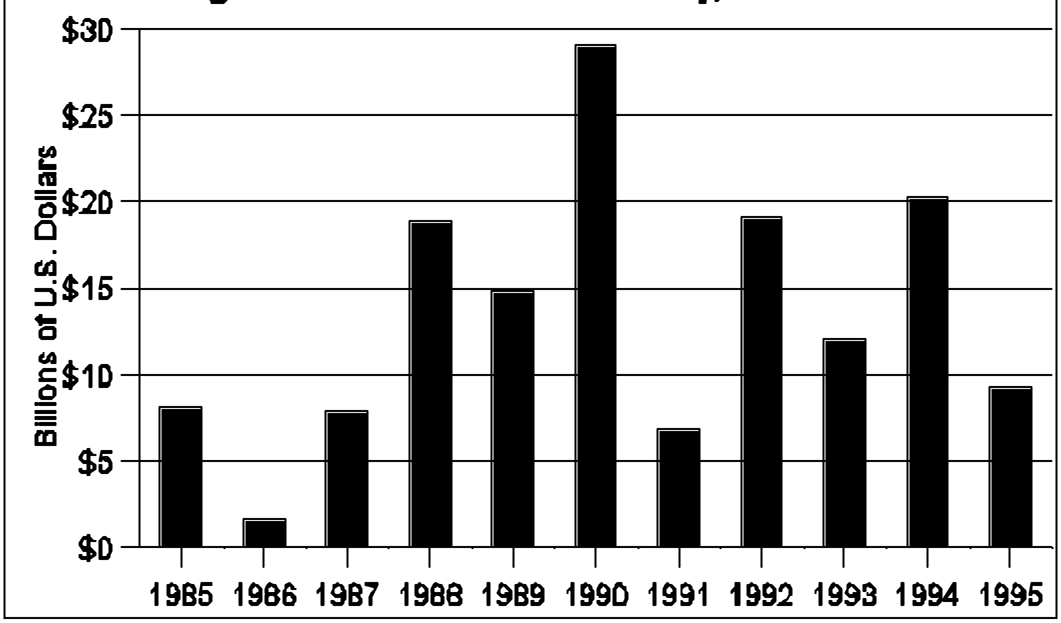
Adapted from New York Bay Company, *What is Debt-for-Development?* (Washington, DC: New York Bay, Ltd., 1996).

The first step may involve a significant amount of effort, but this preliminary preparation can help potential investors avoid failures and can facilitate subsequent steps in the transaction. Unfortunately, many NGOs have neither the expertise and nor the contacts needed to successfully conduct each of these steps.

2. RECENT DEBT CONVERSION ACTIVITY

Since 1985, when Chile instituted the first debt-for-equity swap, debt conversions have totaled \$45.2 billion.[1] Debt conversion activity peaked in 1990, reflecting the conclusion of the first Brady Plan deals and the large privatization efforts then under way. After a significant decline in 1991, activity rebounded in 1992 as a result of debt reduction agreements in Nigeria and the Philippines and a surge of activity in debt swap programs in Argentina and Mexico. Debt conversions declined after 1992, but rose again in 1994, when debt and debt service reduction agreements were negotiated with Brazil, Bulgaria, Dominican Republic, and Poland. ***Figure 2-1*** displays debt conversion levels since 1985.

Figure 2-1. Debt Conversion Activity, 1985–1995



Source: World Bank 1997, p. 85.

[1]World Bank, *Global Development Finance 1997, Volume 1: Analysis and Summary Tables*. (Washington, DC: World Bank, 1997), p. 84.

International financial institutions—the World Bank, IMF, and Inter-American Development Bank (IDB)—agreed to provide funding for voluntary debt reduction to those countries that agreed to undertake growth-oriented adjustment programs and encourage the return of flight capital. Low-income countries that are eligible to borrow from the World Bank's International Development Association (IDA) can buy back debts through the Bank's Debt Reduction Facility. Some Paris Club agreements also provide debt relief to low-income countries by offering concessional terms.

In the early 1990s, leaders of the Group of Seven industrialized countries (G-7) agreed to increase the degree of concessionality offered to the poorest countries. Paris Club creditors subsequently increased the maximum amount of debt relief available. The "Naples terms"—adopted at the G-7 meeting in Naples in 1994—increased the amount of debt available to be restructured to two-thirds. The Paris Club creditors also agreed to go beyond debt rescheduling and to allow countries to restructure their full stock of outstanding debt, if they established a track record of following good macroeconomic adjustment policies and promptly serviced their debt. These "stock-of-debt" operations allow debtor countries to "exit" the rescheduling process and to service debt in the future without seeking additional debt relief. By the end of 1996, six countries had completed stock-of-debt deals and exited the rescheduling process (Uganda, Bolivia, Mali, Guyana, Burkina Faso, and Benin), which reduces a great deal of uncertainty about their future debt obligations. This, in turn, makes these countries less interested in the opportunities for debt conversion.

During 1996, a framework was established for resolving the debt problems of the heavily indebted poor countries (HIPCs). The HIPC Debt Initiative is being implemented through a series of measures to support adjustment and reform efforts in the poorest and most heavily indebted countries to help ensure that their debt is reduced to a sustainable level. As part of this initiative, the World Bank established a HIPC Trust Fund and set aside $500 million for its initial contribution. The International Monetary Fund (IMF) will conduct special Enhanced Structural Adjustment Facility operations in support of the initiative. The Paris Club has agreed to go beyond the Naples terms to provide debt reduction of up to 80 percent in some cases. Those countries that are offered these highly concessional terms may have less interest in future debt conversion arrangements.

Debt-for-equity swaps were negligible in 1995—the only two transactions were in Peru and totaled only about $200 million. Debt-for-equity swaps also were a minimal part of the debt relief package put together for Mexico at the end of 1995. Debt-for-development swaps also have declined dramatically during the 1990s. Only about $88 million was involved in such transactions during 1995.[2]

---

[2]World Bank, *Global Development Finance 1997, Volume 1: Analysis and Summary Tables*. (Washington, DC: World Bank, 1997), p. 85.

As with any commodity, when the supply of developing country debt is reduced and the demand remains constant, the price rises. The following chain of events describes why the prices of debt in developing countries have increased, reducing their attractiveness for debt conversion. As a developing country reduces its overall level of indebtedness through successful debt reduction programs, the chances that the country will service and repay its remaining loans improves. As creditors perceive the higher likelihood of being repaid, their incentive to reduce their lending exposure to this particular country decreases. This change in the creditors' perceptions in turn leads them to increase the price (i.e., reduce the discount) at which they would be willing to sell debt, thus moving the market value of the remaining debt toward its original price and squeezing the potential gains of a debt conversion transaction.

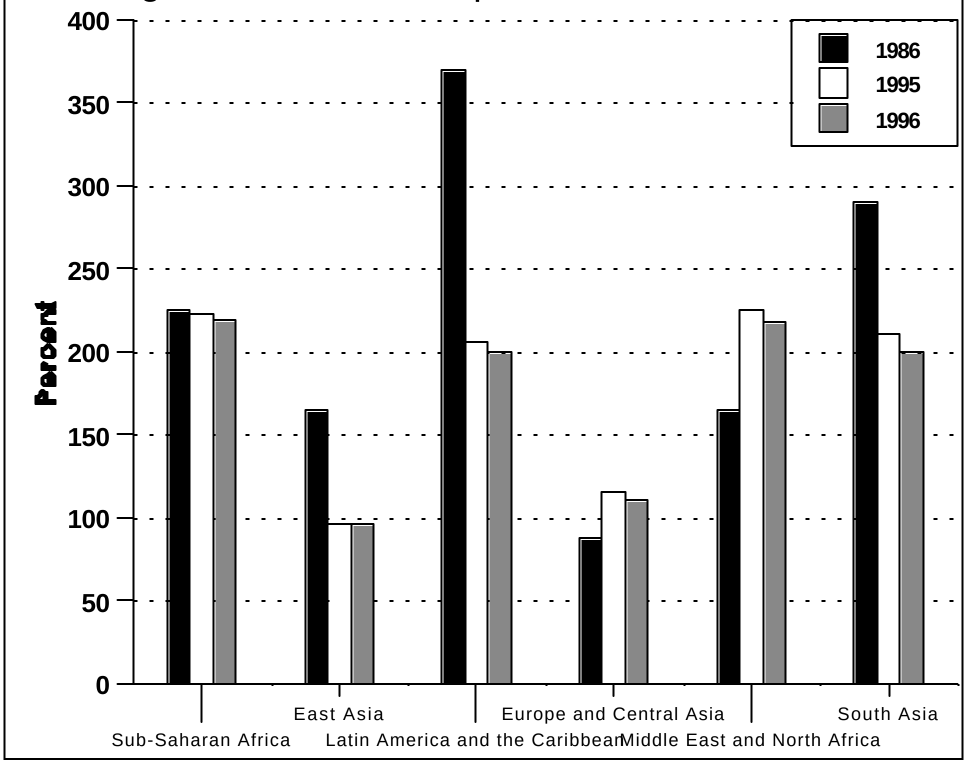
After 1993, the price of sovereign debt increased as debtor countries restructured their commercial debt under the Brady Plan. This reduced both the risk of default and the incentive for lenders to convert debt at a discount. These restructuring operations also helped many of these countries to improve their relations with commercial lenders. This reduces their need for and interest in debt conversion. In fact, during 1996, Mexico and the Philippines were able to swap their Brady Bonds for uncollateralized long-term bonds, which attests to the renewed confidence of investors in the economic prospects of these countries.

The bulk of debt that has been converted since 1985 was owed by Latin American and Caribbean countries, and the relative indebtedness of countries in this region has dropped dramatically since 1986 (see ***Figure 2-2).*** The debt burden of Sub-Saharan Africa remains high, and debt levels are growing in many Sub-Saharan countries. Africa's weak hard currency export earnings and low inward investment put many African countries at risk of failing to service their debts. In fact, 31 of the 48 countries in the region are classified as heavily indebted low-income countries. Almost all of Africa's external debt is bilateral (i.e., owed by governments or to governments), which means it is generally not easy to convert.

The opportunities for debt-for-equity swaps have declined dramatically during the 1990s and are now virtually nonexistent. As mentioned above, only two significant swaps were conducted in 1995, both in Peru as part of privatizing the electric utility in Lima and a major bank. Equity swaps were also used to minimal extent in the debt restructuring package provided to Mexico in late 1995 and early 1996.

The opportunities for debt-for-development swaps also have declined significantly during the 1990s. Nonetheless, the three groups that have been dominant in carrying out debt-for-development activities continue to be active in this area: Finance for Development, New York Bay Company, and the United Nations Children's Fund. FFD and New York Bay conducted swap transactions involving $391 million in debt, including $29.7 million in 1996. The funds generated through these operations have been invested in health, population, agriculture, ecotourism, and low-income housing projects (see ***Figure 2-3).***

Figure 2-2. Debt to Export Ratios, 1986–1996



Source: World Bank 1997, p. 157.

UNICEF has continued the debt-for-child-development programs that it pioneered. By 1996, UNICEF had completed 22 transactions that led to debt reduction of $199 million and generated local currency funds worth $53 million, which were invested in programs to support primary education, women in development, improvements in primary health and sanitation, and aid for children in special need (see ***Figure 2-4).***

The proceeds from debt-for-nature swaps have been used to establish and protect nature preserves in developing countries. The first debt-for-nature swap occurred in 1987, involving Conservation International (CI) and the Bolivian government. Like other conversion operations, the use of debt-for-nature swaps has declined during the 1990s (see ***Figure 2-5).*** Only one debt-for-nature swap occurred during 1996, and this involved only $391,000 in debt.

Figure 2-3. Debt Conversions by Finance for Development and New York Bay, 1992–1996 (millions of U.S. dollars)

Year	Country	Debt Retired
mid-1996	Mexico	$22.5
mid-1996	Nigeria	7.2
1995	Mexico	37.5
1995	Philippines	3
1995	Nigeria	6.8
1995	Tanzania	9.6
1995	Bolivia	32.7
1994	Mexico	92.1
1994	Philippines	13
1994	Nigeria	1.5
1994	South Africa	18.8
1994	Zambia	86.9
1993	Mexico	15.4
1993	Philippines	8
1993	Nigeria	1.7
1993	South Africa	7.4
1993	Tanzania	4.4
1993	Kenya	8.6
1993	Zambia	0.1
1992	Mexico	4.2
1992	Philippines	1.5
1992	Kenya	1

Source: World Bank, Global Development Finance, Volume 1: Analysis and Summary Tables. *Washington: World Bank, 1997, p. 88.*

Figure 2-4. Debt-for-Child-Development Swaps by UNICEF, 1989–1995
(thousands of U.S. dollars)

Year	Country	Face Value of Debt	Cost	Development Funds (value of local currency)
1995	Mexico	6,400	3,647	4,935
1994	Madagascar	2,000	1,000	2,000
1994	Madagascar	1,200	576	950
1994	Peru	10,880	0	2,720
1994	Zambia	66,614	7,328	10,990
1994	Mexico	1,870	1,015	1,902
1993	Philippines	250	0	180
1993	Philippines	1,226	864	1,000
1993	Bolivia	15,000	2,400	3,600
1993	Madagascar	2,000	940	2,000
1993	Senegal	24,000	60,000	11,000
1992	Jamaica	4,000	2,877	4,000
1992	Philippines	486	245	329
1992	Sudan	38,068	0	1,200
1991	Sudan	5,000	0	460
1991	Sudan	3,000	0	276
1990	Sudan	7,023	0	801
1989	Sudan	2,732	0	244
1989	Sudan	2,732	0	225
1989	Sudan	800	0	80

Source: World Bank, Global Development Finance, Volume 1: Analysis and Summary Tables. *Washington: World Bank, 1997, p. 88.*

Figure 2-5. Debt-for-Nature Swaps, 1987–1996 (thousands of U.S. dollars)

Year	Country	Face Value	Cost to Donor	Conservation Funds (value of local currency)
1996	Mexico	391	192	254
1995	Mexico	488	246	337
1994	Mexico	290	248	290
1994	Mexico	480	399	480
1994	Mexico	280	236	280
1994	Madagascar	2,000	50	2,000
1993	Madagascar	5,000	3,200	5,000
1993	Philippines	1,900	13,000	17,700
1993	Mexico	252	208	252
1992	Ecuador	NA	NA	1,000
1992	Brazil	2,200	746	2,200
1992	Bolivia	11,500	NA	2,800
1992	Guatemala	1,300	1,200	1,300
1992	Panama	NA	NA	30,000
1992	Ecuador	1,000	NA	NA
1992	Philippines	9,900	5,000	8,800
1992	Mexico	44	355	441
1991	Ghana	1,000	250	1,000
1991	Jamaica	437	300	437
1991	Guatemala	100	75	90
1991	Mexico	250	NA	250
1991	Nigeria	149	65	93
1991	Philippines	NA	NA	8,000
1991	Mexico	250	183	250
1991	Costa Rica	600	360	540
1991	Madagascar	119	59	119
1990	Madagascar	919	446	919
1990	Philippines	900	439	900
1990	Madagascar	5,000	NA	5,000
1990	Costa Rica	10,800	1,900	9,600

Year	Country	Face Value	Cost to Donor	Conservation Funds (value of local currency)
1990	Dominican Republic	582	116	582
1990	Poland	NA	NA	50
1989	Zambia	2,300	454	2,300
1989	Madagascar	2,100	950	2,100
1989	Ecuador	9,000	1,100	9,000
1989	Costa Rica	24,500	3,500	17,100
1989	Costa Rica	5,600	784	1,700
1989	Philippines	390	200	390
1988	Costa Rica	33,000	5,000	9,900
1988	Costa Rica	5,400	918	5,400
1987	Ecuador	1,000	354	1,000
1987	Bolivia	650	100	250

NA = not available

Source: World Bank, Global Development Finance, Volume 1: Analysis and Summary Tables. *Washington: World Bank, 1997, p. 87.*

3. CURRENT OPPORTUNITIES FOR DEBT CONVERSION

The popularity of debt conversions has evolved since it emerged in 1989 as a mechanism for dealing with the heavy indebtedness of many developing countries. The international response to the debt crisis, including the Brady Plan and the continual Paris Club negotiations, achieved the desired result of reducing the volume of unserviced debt owed by developing countries. This has limited the opportunities available for leveraging development resources through debt conversion. In particular, the potential gains of such operations are limited by the higher prices for debt (i.e., lower discounts) on the secondary market and the fact that many developing countries have reduced their debt to more sustainable levels and therefore have fewer incentives to seek debt conversion. There are some opportunities for debt conversion in Sub-Saharan Africa, where most countries remain heaviliy indebted. However, because most of the debt of these countries is bilateral—owed to and by governments—exploiting these opportunities will require creation of formal debt conversion programs with clearly established procedures.

Few countries have formal debt conversion programs that are still active and open. Ad hoc debt conversion transactions are more common, under which the debtor countries evaluate individual proposals, taking into consideration the amount of local currency available at the time and the development value of the proposed project. Some programs that are officially open are dormant because little debt remains available for conversion.

In recent years, the diminishing debt-for-development activity has continued to be dominated by three organizations: Finance for Development (which is no longer in operation), New York Bay Company, and UNICEF. These organizations were pioneers in negotiating debt-for-development swaps and have built up an institutional expertise in implementing these arrangements over the past decade. Debt swaps involve significant expertise and carry high transaction costs. The more limited potential returns now available mean that such ventures will be unprofitable for organizations that lack the necessary skills or experience in this area.

BIBLIOGRAPHY

Finance for Development (previously Debt-for-Development Coalition). Interviews with staff from Finance for Development. Washington, DC, 1996.

International Monetary Fund (IMF). *Exchange Arrangements and Exchange Restrictions, Annual Report.* Washington: International Monetary Fund, 1995.

New York Bay Company, Ltd. *What is Debt-for-Development?* Washington: New York Bay, Ltd., 1996.

PROFIT. *Blocked Funds / Debt Conversion Study: An Analysis of the Marketplace*. Arlington, VA: PROFIT Project, 1995.

Ross, John B. *Debt Conversion and Africa: Background paper for Presentations to Maastricht Meeting*, New York: New York Bay Company, 1995.

Sung, W., and R. Troia. *Developments in Debt Conversions Programs and Conversion Activities.* World Bank Technical Paper 170. Washington: World Bank, 1992.

World Bank. *Global Development Finance, Volume 1: Analysis and Summary Tables.* Washington: World Bank, 1997.

World Bank. *World Bank Debt Tables 1994–1995: External Finance for Developing Countries.* Washington: World Bank, 1995.

World Bank. *World Bank Debt Tables 1992–1993: External Finance for Developing Countries.* Washington: World Bank, 1993.

Appendix 1. The World Bank's Classification of Indebted Countries

Severely indebted low-income	Severely indebted middle-income	Moderately indebted low-income	Moderately indebted middle-income	Less-indebted low-income	Less-indebted middle-income
Angola	Argentina	Bangladesh	Algeria	Albania	Barbados
Burundi	Bolivia	Benin	Arab Rep. of Egypt	Armenia	Belarus
Cambodia	Brazil	Burkina Faso	Chile	Azerbaijan	Belize
Cameroon	Bulgaria	Chad	Colombia	Bhutan	Botswana
Central African Rep.	Ecuador	Comoros	Hungary	China	Cape Verde
Congo	Gabon	The Gambia	Indonesia	Georgia	Costa Rica
Côte d'Ivoire	Jamaica	Haiti	Macedonia, FYR	Kyrgyz Rep.	Croatia
Equatorial Guinea	Jordan	India	Morocco	Mongolia	Czech Rep.
Ethiopia	Mexico	Lao PDR	Papua New Guinea	Nepal	Djibouti
Ghana	Panama	Pakistan	Philippines	Sri Lanka	Dominica
Guinea	Peru	Senegal	Poland	Tajikistan	Dominican Republic
Guinea-Bissau	Syrian Arab Rep.	Zimbabwe	Russian Federation		El Salvador
Guyana			St. Vincent		Estonia
Honduras			Trinidad and Tobago		Fiji
Kenya			Tunisia		Grenada
Liberia			Turkey		Guatemala
Madagascar			Uruguay		Islamic Rep. of Iran
Malawi			Venezuela		Kazakstan
Mali			Western Samoa		Latvia
Mauritania					Lebanon
Mozambique					Lesotho
Myanmar					Lithuania
Nicaragua					Malaysia
Niger					Maldives
Nigeria					Malta
Rwanda					Mauritius
São Tomé and					Moldova
Sierra Leone					Oman
Somalia					Paraguay
Sudan					Romania
Tanzania					Seychelles
Togo					Slovak Republic
Uganda					Slovenia
Vietnam					Solomon Islands
Yemen Republic					St. Kitts and Nevis
Zaire					St. Lucia
Zambia					Swaziland
					Thailand
					Tonga
					Turkmenistan
					Ukraine
					Uzbekistan
					Vanuatu

Source: World Bank, *Global Development Finance 1997, Volume 1: Analysis and Summary Tables.* (Washington: World Bank, 1997), p. 51.

Appendix 2. Survey Methodology

As part of this study, emerging markets experts were surveyed during February 1996 regarding debt conversion opportunities worldwide, with specific inquiries about PROFIT's target countries. Interviews were conducted with emerging market debt traders at Bankers Trust, Chemical Bank, Citibank, Goldman Sachs, National Westminster, Republic Bank, and Solomon Brothers. Debt-for-development experts were contacted at Finance for Development (formerly the Debt-for-Development Coalition), New York Bay Company, Ltd., the International Finance Corporation, and private investment specialists active in international corporate and project finance.

General information on debt conversion trends and opportunities was gathered through discussions with partners in law firms in Washington and New York who were involved in debt conversion transactions and in private investment companies that specialize in development finance.

The World Bank's *World Debt Tables 1994–1995* was used as a reference guide for the first draft, prepared in early 1996. The Bank's *Global Development Finance 1997* was used to update the draft in May 1997.